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IS MISTAKE DEAD IN CONTRACT LAW?

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The role of the doctrine of mistake has recently been considered by the Court of Appeal and the House of Lords in England. While not completely abolishing the doctrine, the decisions of these courts have narrowed its application and focused attention on this area of contract law and the usefulness and fairness of its operation. This article reviews these cases and considers the role of the doctrine in comparison with overlapping areas of contract law. It also examines the impact on Hong Kong law and the future of the doctrine from a practical point of view and in the light of the advances made in the area of information technology.

Introduction

The role of the doctrine of mistake has recently been examined by the higher courts in England. In *Great Peace Shipping Limited v Tsavliris (International) Limited*, the Court of Appeal has narrowed the application of equity in the area of common mistake.[1] Then, at the end of 2003, the House of Lords in *Shogun Finance Limited v Hudson* reaffirmed the strong presumption in cases of unilateral mistake that, in face-to-face situations, the contract is intended to be with the person the offeror is face to face with and not with some other person that may have been in the mind of the mistaken party.[2] Both cases have, therefore, resulted in restrictions being placed on the role of the doctrine of mistake. This role has been questioned repeatedly in the past with some persuasive arguments for the proposition that there is no room in contract law for such a doctrine, as it overlaps with other areas of contract law that do a much better job of achieving fairness between parties to a contract while at the same time preserving business certainty.

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1 [2002] EWCA Civ 1407.

2 [2003] 3 WLR 1371.

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Mistake as an Issue

The issue of mistake only becomes relevant if the contract itself does not readily identify and allocate to the parties responsibility for mistakes. This has been recognised in a number of cases such as *William Sindall plc v Cambridgeshire CC*.[3] The doctrine, in practice, therefore only operates where the parties are relatively unsophisticated and have not put much thought or expertise into the drafting of the contract and allocated the risks, including those of mistaken assumptions accordingly.[4] There have been calls to rationalise the effect of mistake cases by the allocation of risk – either by the parties themselves in the contract terms or else by the courts. Indeed, it has been argued that there is no doctrine of mistake in English law.[5]

Theoretical Basis of Mistake

In *Bell v Lever Bros*, Lord Atkin said: "If mistake operates at all, it operates so as to negative, or in some cases to nullify consent."[6] Treital explains that this means that mistake negatives consent where it prevents the parties from reaching agreement and it nullifies consent where the parties have reached agreement but one based on a fundamental mistaken assumption.[7] One example would be an agreement to paint a portrait of someone who, unknown to the parties, has died.

It is useful when discussing the application of the doctrine of mistake to categorise the different types of mistake. According to a leading English academic text, mistake in contract law can be divided into: unilateral, mutual and common.[8] Unilateral mistake occurs where one party is aware of the other's mistake; mutual mistake arises when the parties are at cross purposes; and common mistake arises when the parties are in agreement, but that agreement assumes some fact to be true when it is not. Cases of unilateral mistake often involve a "rogue" who passes himself off as someone else and deceives the other party into entering into a contract with him.

3 [1994] 3 All ER 932. Hoffmann LJ quoted Steyn J in *Associated Japanese Bank (International) Ltd v Credit du Nord SA* [1988] 3 All ER 902: "Logically, before one can turn to the rules as to mistake, whether at common law or equity, one must first determine whether the contract itself, by express or implied condition precedent or otherwise, provides who bears the risk of the relevant mistake."

4 A comparison can be made with frustration which occurs after the contract has been entered into. It is easier to allocate risks already known to the parties when entering into the contract than to foresee future events and, therefore, make provision for the effects of such events in the contract.

5 Ho, B., *Hong Kong Contract Law* (Hong Kong: Butterworths, 2nd edn, 1994), p 207.

6 [1932] AC 161.

7 Treital, G.H., *The Law of Contract* (London: Sweet & Maxwell, 10th edn, 1999), p 262.

8 Furmston, M.P., *Cheshire, Fifoot and Furmston's Law of Contract* (London: Butterworths, 14th edn, 2001), p 252.

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The effect of an operative mistake at law is to render the contract void *ab initio*. The bars to rescission are overridden and this has serious consequences for a third party who may have acquired the property in question from the victim of the mistake. Equity, at least until recently, has had a wider scope but an effect which is less drastic.[9]

Bell is generally regarded as the leading case in the area of common mistake. However, one wonders just how strong an authority it is now considering its age and the fact that in *Bell*, the first instance judgment in favour of Lever Bros was affirmed by a unanimous Court of Appeal and was overturned only by a three to two majority in the House of Lords. Even then only two of the Lords – Lord Atkin and Lord Thankerton – analysed this as a case where an operative common mistake did not exist.

The House of Lords in *Bell* held that for any mistake to be operative it had to be about something which was fundamental to the contract. In this case, employees were paid compensation for the termination of their contracts with the employer. The employer would have been able to dismiss them anyway without compensation because of certain breaches of the service contracts by the employees. The employer argued that the contracts for compensation were void for mistake. The House of Lords, while recognising the possibility of a contract being void where there was a fundamental mistake as to the subject matter of the contract, nevertheless held that on the facts the contracts were not void. The test established by the majority was expressed by Lord Thankerton who said that the common mistake must "relate to something which both parties must necessarily have accepted in their minds as an essential element of the subject matter." The claimants paid £50,000 to the defendants – a huge sum in 1929 – when they could have dismissed them without paying any compensation.[10] Why was the mistake not fundamental? The answer to this question is not entirely clear. McKendrick suggests that a partial answer is that the court did not want to lay down a principle which would enable parties to escape from what was merely a bad bargain.[11] More interestingly, he suggests that on closer analysis of the facts, the mistake may not have been as significant as it appears at first sight. It seems that the claimants were very anxious to carry through the reorganisation of the company and to secure the defendants' consent to the termination of their service

9 The equitable remedies of rescission, refusal of specific performance and rectification may be available.

10 A party bringing a civil action in England is called a "claimant". In Hong Kong the courts still use the term "plaintiff". Oddly enough though, a party starting a claim in the Small Claims Tribunal in Hong Kong is called a "claimant": s 2 of Small Claims Tribunal Ordinance (Cap 338).

11 McKendrick, E., *Contract Law* (Basingstoke, Hampshire: Macmillan Press, 4th edn, 2000), p 292. McKendrick is also an editor of the leading practitioners' text *Chitty on Contracts*.

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agreements. This anxiety and urgency suggested to the majority of their Lordships that the claimants might have entered into the same agreements, even if they had known of the defendants' breaches of duty. The existence of such a doubt was fatal to their claim as they had the burden of proof.

Whatever the interpretation of the test formulated by Lord Thankerton above, it is clear that a claimant who, like the claimants in *Bell*, has to prove his case, is faced with a major hurdle in successfully establishing an operative mistake following the decision in *Bell*.

The existence of the subject matter is obviously fundamental as in *Galloway v Galloway* where a separation deed between a man and a woman, who mistakenly thought they were married to each other, was held to be void.[12] The quality of the subject matter, as in *Bell*, may or may not be fundamental depending on the circumstances. The decision in *Bell* does make it very difficult to see when a common mistake will be operative otherwise than in the *res extincta* category.[13] In the more recent case of *Associated Japanese Bank (International) v Credit du Nord*, Steyn J discussed *Bell* and held that a mistake could make a contract void provided that it rendered the contract "essentially and radically" different from the one the parties thought they were making.[14] However, this does not seem to make it any easier to establish an operative common mistake as the facts in *du Nord* were "fairly close" to classic *res extincta* cases. Here, a rogue represented to the plaintiff that he owned industrial machines. The plaintiff reasonably believed that the machines existed and entered into a sale and leaseback transaction with the rogue. The defendant guaranteed the rogue's obligations under the leaseback transaction. The rogue defaulted and it was discovered that the machines never existed. The question before the court was whether the guarantee of obligations under a lease for non-existent machines was essentially different from a guarantee of obligations under a lease with machines. The court held that it was and the guarantee was void for mistake.

Lord Atkin gave, in *Bell*, four examples of a contract not vitiated by mistake: sale of an unsound horse; sale of a modern copy of an old master painting; lease of an uninhabitable house; and sale of a roadside garage about to be rendered worthless by construction of a bypass.[15] In the absence of a warranty or representation on the point, these contracts were said to stand.

[12] (1914) 30 TLR 531.

[13] Latin for "matter has ceased to exist". Similar considerations apply to "res sua" cases where the subject matter of a contract already belongs to the intended purchaser.

[14] [1988] 3 All ER 902.

[15] *See* n 6 above, p 224.

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Is Common Mistake Just a Total Failure of Consideration?

If one is to conclude that the only role for the doctrine of mistake in cases of common mistake is where the subject matter does not exist at the time the contract was entered into, an argument could be mounted that one can do away completely with the doctrine of mistake where there is a common mistake as this scenario can be covered by treating it as just an example of where there is a complete failure of consideration. If the subject matter of the contract does not exist, then the party who has the obligation to provide such subject matter cannot perform *his* part of the contract.

Indeed, in several nineteenth century English cases, money paid out by a party under circumstances which today would ground a common mistake was recovered on the basis of total failure of consideration.[16] Chitty explains that there were three possible conceptual routes which were employed in considering whether a fundamental mistake had prevented the formation of a valid contract: total failure of consideration; that the contract was subject to an express or implied condition that the facts were as the parties believed them to be; and that there was a separate doctrine of mistake.[17] The second route of the implied term arose out of the analogy with frustration but the notion of frustration based on an implied term has now been discarded by the courts. One is left with the other two routes. Chitty makes the argument that:

> "the fact that a mistake has led to there being a total failure of consideration cannot lead straight to the conclusion that the contract is void, since it might be that the seller is liable for non-performance. In other words, total failure of consideration is not an independent ground on which a contract may be held void."

The correct conclusion appears to be that there is a separate doctrine of mistake. This is supported by Lord Atkin in *Bell* and the English Court of Appeal in *Great Peace Shipping*. While they appear to differ over the origin of the doctrine – the former reflecting the Roman notion of mistake,[18] while the latter based on parallels to frustration and construction of the contract – they proceed on the basis that there is a separate doctrine of mistake.

[16] *See* cases cited in Beale, H.G., *Chitty on Contracts* (London: Sweet & Maxwell, 29th edn, 2004), para 5–017.
[17] *Ibid.*, para 5–016.
[18] *Ibid.*, para 5–020.

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The Role of Equity in Mistake

In *Great Peace Shipping*, the power to rescind a contract in equity, derived from *Solle v Butcher*,[19] has been firmly rejected by the English Court of Appeal. The parties in *Great Peace Shipping* were mistaken about the location of the merchant vessel the *Great Peace* in relation to the evacuation of the crew of another vessel. Both parties thought that the *Great Peace* was "in close proximity" but that turned out to be erroneous. In other words, there was a common mistake. The court found that the mistake was not operative because, even though the distance that the *Great Peace* was away was large, it was not so far away as to be incapable of providing the required service under the contract. Before the decision in *Great Peace Shipping*, *Solle* had been followed in England for over 50 years. This was despite the fact that the ratio of *Solle* is difficult to distil and is hard to reconcile with the decision in *Bell*. All three judges in the Court of Appeal in *Solle* adopted different approaches in coming to their decisions. The facts in this case were that the parties, a landlord and tenant, had entered into a lease agreement under the mistaken assumption that the flat was free from rent control after the premises had undergone extensive alterations. Bucknill LJ said that the operative mistake made was that the alteration work on the flat had made it a different flat. He said this was a common mistake of fact. Lord Denning said that the mistake made was that the flat was not tied down to a controlled rent whereas in fact it was. Jennings LJ, who gave a dissenting judgment, said that mistake made was a mistake of law and was, therefore, not operative.[20]

Lord Denning noted the drastic effects of finding a contract void at law. He stated his interpretation of the ratio in *Bell* as follows:

> "The correct interpretation of that case, to my mind, is that, once a contract has been made, that is to say, once the parties, whatever their inmost states of mind, have to all outward appearances agreed with sufficient certainty in the same terms on the same subject matter, then the contract is good unless and until it is set aside for failure of some condition on which the existence of the contract depends, or for fraud, or on some equitable ground."

On the last ground he noted that the court of equity would often relieve a party from the consequences of his own mistake, so long as it could do so "without injustice to third parties". He then went on to say that this power to

[19] [1949] 2 All ER 1107.

[20] The distinction between a mistake of fact and a mistake of law has now been removed by the House of Lords in *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All ER 513.

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set aside the contract could be exercised whenever the court was of the opinion that it was unconscientious for the other party to avail himself of the legal advantage which he had obtained. He added that if a contract was not void for mistake at common law it could still be rescinded and set aside in equity if the mistake was *fundamental*.

The difficulty with the exposition of this equitable doctrine was addressed by Lord Phillips in *Great Peace Shipping*. In his leading judgment he listed and discussed a number of cases which had followed *Solle*.[21] He remarked:

> "yet none of them defines the test of mistake that gives rise to the equitable jurisdiction to rescind in a manner which distinguishes this from the test of mistake that renders a contract void at law, as defined in *Bell v Lever Brothers*".[22]

Lord Phillips said the effect of *Bell* was to recognise that the intervention of equity took place only in circumstances where the common law would have ruled the contract void for mistake. He agreed with the judge at first instance,[23] that the doctrine of common mistake leaves no room for the intervention of equity.[24] In words very similar to those in the paragraph above the judge had concluded that it was "not possible to differentiate between the test of mistake identified in *Bell v Lever Brothers* and that advanced by Lord Denning as giving rise to the equitable jurisdiction to rescind."[25]

While deciding that there was no equitable jurisdiction to rescind on the ground of common mistake a contract that was valid at common law, the court did recognise that there was a need for a codified doctrine of common mistake which allows for an appropriate element of discretion in determining the terms of any court order relieving the parties of their bargain. Lord Phillips said:

> "just as the Law Reform (Frustrated Contracts) Act 1943 was needed to temper the effect of the common law doctrine of frustration, so there is scope for legislation to give greater flexibility to our law of mistake than the common law allows."[26]

[21] *Rose v Pim* [1953] 2 QB 450; *Grist v Bailey* [1967] 1 Ch 532; *Magee v Pennine Insurance Co Ltd* [1969] 2 QB 507; *Laurence v Lexcourt Holdings* [1978] 1 WLR 1128.

[22] *See* n 1 above, para 153.

[23] Toulson J.

[24] Toulsin J had rather colourfully described the decision by Lord Denning in *Solle* as one which sought to outflank *Bell v Lever Brothers*.

[25] *See* n 1 above, cited at para 97.

[26] *See* n 1 above, para 161. Hong Kong enacted similar provisions, *see* ss 16 to 18 of Law Amendment and Reform (Consolidation) Ordinance (Cap 23) (LARCO).

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This need, it appears, is now greater than ever before because the explosion of the idea of a separate equitable jurisdiction by the Court of Appeal in *Great Peace Shipping* has resulted in the loss of the flexibility that the equitable doctrine had brought to the doctrine of mistake.

Unilateral Mistake: The Rogue Cases

In the area of unilateral mistake, one of the abiding mysteries has been the different decisions, on similar facts, of *Lewis v Averay*,[27] and *Ingram v Little*.[28] The former case featured a rogue who pretended to be Richard Greene, the then famous actor well-known for portraying Robin Hood in a long-running television series. The rogue signed a cheque in the name of "R.A.Greene" in order to purchase a car. Lewis asked if he had anything to prove he was Richard Greene and the man produced an admission pass to Pinewood Studios, bearing an official stamp, the name of "Richard A Greene" and a photograph of the man. The man was not Richard Greene and the cheque bounced. The rogue then sold the car to a bona fide purchaser, Averay. The Court of Appeal held that the mistake was not operative and that Averay had acquired good title to the car. Lord Denning said:

> "there is a contract made with the very person there, who is present in person. It is liable no doubt to be avoided for fraud, but it is still a good contract under which title will pass unless and until it is avoided."

By contrast, in *Ingram v Little*, a differently constituted Court of Appeal held that the mistake was operative. Here a rogue, introducing himself as Hutchinson, offered to buy a car from the plaintiffs. He was taken for a run in the car in the course of which he talked about his family and said they were in Cornwall but that his home was in Caterham. Later, the rogue offered a sum to Elsie Ingram for the car which she was prepared to accept. She refused to accept a cheque from him. He then said he was a P.G. Hutchinson with business interests in Guilford and living at Stanstead House, Stanstead Road, Caterham. Hilda Ingram then checked in the telephone directory that there was such a person as P.G. Hutchinson living at that address. The plaintiffs then let the rogue have the car in exchange for the cheque. The court said that the identity of the person with whom the Ingrams were dealing was fundamental and that the contract was void for mistake.

[27] [1971] 3 WLR 603.
[28] [1961] 1 QB 31.

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Lewis and *Ingram* are very difficult to reconcile as the results go different ways on facts that are very similar. Some writers agree that *Lewis* appears to be the correct decision and point out that *Lewis* was decided some 10 years after *Ingram*.[29] In *Ingram*, Devlin LJ gave a strong dissenting judgement. He used the presumption that a person is intending to contract with the person to whom he is addressing his words as a starting point. On the facts he found this presumption had not been rebutted. The position had been unclear, though, until the House of Lords considered the position in *Shogun Finance Limited v Hudson*.

In *Shogun Finance*, the House of Lords affirmed the principle that, in face-to-face cases, there is a strong presumption that the contract is intended to be with the person the offeror is face to face with as in *Lewis* and *Ingram* and many other cases.[30] The result is that the chances of establishing an operative mistake on similar facts to these cases is reduced almost to zero and *Ingram*, which has long been doubted, has probably been dealt a fatal wound, being criticised by some of the Lordships.

The rogue in *Shogun Finance* went into a car showroom and showed an interest in purchasing on hire-purchase a Mitsubishi Shogun car. He posed as a Mr Patel and used Mr Patel's driving licence – which he had improperly obtained – and address to evidence his false identity. This information was passed on by fax to Shogun Finance. They checked Mr Patel's credit rating and then instructed the car dealer, by phone, to pass possession of the car to the rogue. A written contract of hire-purchase was entered into by Shogun Finance naming Mr Patel as the hire-purchaser and the rogue signed it, forging Mr Patel's signature. The rogue then sold the car to Hudson and disappeared with the proceeds of sale. Shogun brought a claim against Hudson for the tort of conversion. The case turned on whether Mr Hudson had acquired good title to the car from the rogue.

At trial, the judge held that there was no valid contract between the rogue and Shogun Finance and so found for Shogun Finance. Mr Hudson appealed to the Court of Appeal, which upheld, by a majority, the judge's decision. The House of Lords dismissed the appeal by a bare majority made up of Lord Hobhouse, Lord Phillips and Lord Walker. Lord Millett and Lord Nicholls dissented. The House found there was no valid contract between Shogun Finance and the rogue. The contract was made between Shogun Finance and Mr Patel. This was a nullity as it had been made without Mr Patel's authority.

[29] *See* McKendrick (n 11 above), p 72.

[30] *Cundy v Lindsay* [1876] 1 QBD 348; *Phillips v Brooks* [1919] 2 KB 243; *Boulton v Jones* [1857] 2 H&N 564; *Hardman v Booth* (1863) 1 H&C 803.

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While affirming the strong presumption in face-to-face cases that the offer is intended to be made to the physical individual present (in this case, the rogue), the face-to-face principle could not, however, apply to contracts made by written documents such as email, post or *Shogun Finance* itself, because in these cases the scope of the offer and acceptance must be found in the correspondence. *Shogun Finance* does have elements of the face-to-face situation. Much was concluded face-to-face with the car dealer as an agent for some purposes of Shogun Finance. However, the House of Lords said the written document specified the parties and must prevail.

Some observers may feel that the affirmation of the strong presumption mentioned above in face-to-face cases which narrows the application of the mistake, may not be of great significance as the incidence of unilateral mistake cases is rare. Lord Millett in *Shogun Finance* said precisely this. He observed: "the situation seems artificial and is one which is seldom likely to arise in practice, at least in the absence of fraud." However, he then went on to say that unfortunately fraudulent impersonation is not at all uncommon in the present day and age. Lord Walker in the same case suggested that contracts made over the telephone should be treated as face-to-face contracts. Videophones, mentioned in this case, would presumably also be treated as face-to-face situations. Lord Millett also made reference to modern technology and noted that in the emerging era of e-shopping over the Internet, "identity theft" impersonations are on the increase.

Fraud Cases: The Role of Criminal Law

In the United Kingdom, significant steps have been taken to tackle the growing problem of fraud. The Law Commission has advocated the creation of a single offence of fraud to make it more comprehensible to juries especially in serious fraud trials.[31] Having a single offence of fraud would also be a useful tool for the effective prosecution of fraud from investigation through to trial. The Commission advocates that the eight offences of deception created by the Theft Acts 1968–1996 should be repealed and the common law crime of conspiracy to defraud should be abolished. In their place it recommends the creation of two new statutory offences – one of fraud and one of obtaining services dishonestly.

One of the areas of fraud targeted is identity theft. This was the type of case referred to in *Shogun Finance* by Lord Millett. In the United Kingdom, the incidence of such cases has doubled to 75,000 in two years and the cost to

[31] Fraud (2002) Law Com No 276, Cm 5560.

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victims amounted to £62.5 million.[32] It seems, therefore, that criminal law, in England at least, is making a serious attempt to meet the challenges of modern information technology in the area of fraudulent rogue cases. This stands in stark contrast to the civil common law which, following the decision in *Shogun Finance*, provides very little protection to victims of rogue cases.

Who Should Bear the Loss in Rogue Cases?

One issue arising from the rogue cases is how to distribute the loss between two innocent parties – such as Shogun Finance and Mr Hudson. Lord Nicholls, in his dissenting judgment in *Shogun Finance* said "the loss is more appropriately borne by the person who takes the risks inherent in the parting with his goods without receiving payment". He noted that this approach is consistent with approaches adopted elsewhere in the common law world, especially in the United States in their Uniform Commercial Code.[33]

To date, English and Hong Kong law has not provided any remedy allowing losses to be shared. This does seem harsh on the party who misses out on being compensated. Why should a party who has been deceived by a rogue have no remedy simply because he is on the wrong end of a decision about whether or not a mistake is operative or not? In this day and age of sophisticated identity cards, this argument appears to be weak, as all the innocent party has to do is to ask the other party to produce an identity card with a photo on it. Admittedly the use of such cards is far from universal but there are significant moves being made to change this. Hong Kong is currently halfway through the introduction of smart cards. Across the border in mainland China, more than 1 billion new plastic identity cards with embedded microchips are expected to be issued in the coming years. These will replace the paper documents now carried by adult Chinese citizens. Proposals for similar high-tech identity cards have proved controversial in countries such as Australia, the United States and the United Kingdom where the carrying of such cards is not ingrained nearly as deeply as it is in Hong Kong and China.[34] However, in the aftermath of the September 11 attacks on the United

[32] Wright, R., *Getting Serious about Fraud*, available at http://www.nottingham.ac.uk/business/ICCSR/RosWrightLecture.pdf.

[33] Art 3-404 states with regard to negotiable instruments: " if an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorised to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favour of a person who, in good faith, pays the instrument or takes it for value or for collection."

[34] *The Standard*, 4 May 2004, p A10.

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States and the greater need for security, the tide of change in favour of making citizens carry identity cards seems irresistible.

What then is the current role of the doctrine of mistake in contract law? This can be shown by how mistake functions compared with the overlapping areas of contract law, namely, misrepresentation and frustration.

Mistake and Misrepresentation

A misrepresentation is a false statement of fact made by a party to a contract (the representor) which induces the representee to enter into a contract with the representor. Misrepresentation can take one of three forms: fraudulent, negligent and innocent. The effect of an operative misrepresentation is to make the contract voidable at the option of the representee.

It is quite common for a set of facts that gives rise to an action for mistake to also ground an action for misrepresentation. Most cases of unilateral mistake are also cases of fraudulent misrepresentation. If a rogue pretends to be someone else this is clearly a misrepresentation.[35] Given the choice, it is preferable to succeed in mistake as the contract is made void *ab initio* and the victim can recover the property in question. However, in misrepresentation the remedies of rescission and damages may not be of any practical value as the rogue may have sold the property on to a third party and then disappeared never to be found again to be served with a writ.

Remedies for Misrepresentation: Better than for Mistake?

When the English Parliament enacted the Misrepresentation Act 1967, it gave victims of misrepresentation much wider remedies than were previously available under the common law. Before the enactment of this Act a claimant in English law could only claim rescission for all types of misrepresentation: fraudulent, negligent and innocent.[36] However, rescission is limited as a remedy by the equitable bars: affirmation, lapse of time, impossibility of restoring the parties to their original positions and acquisition of third party rights.

The Act now gives a right to damages, in lieu of rescission, for non-fraudulent misrepresentation, namely, negligent and innocent misrepresentation. The question whether damages are available for innocent misrepresentation

[35] The representation can take the form of a positive assertion of fact uttered by the rogue or inferred from his conduct.

[36] The setting aside of a voidable contract, which is thereby treated as if it had never existed.

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when the right to rescission has been barred has proven to be controversial.[37] If the right to rescission and the right to damages for innocent misrepresentation are not available to a claimant he can still obtain an indemnity.[38]

Damages are available for negligent misrepresentation – the most commonly litigated form of misrepresentation – whether or not rescission is barred. The issue that has arisen here has been what the level of damages should be. The leading case is *Royscott v Rogerson* where the English Court of Appeal held that the level of damages available for negligent misrepresentation was that of the tort of deceit.[39] The court arrived at this conclusion by simply interpreting the wording of the Act.[40] This has made a claim for misrepresentation much more attractive than before the Act came into force.

However, if one is the victim of a rogue case, discussed below, rescission may well be barred because of lapse of time or acquisition of third party rights. Rogues usually are quick to sell the "hot" goods and then disappear. The alternative remedy of damages may be a hollow one as it will probably be impossible to track the rogue down to enforce any judgment against him.

Damages for Misrepresentation in Hong Kong

Hong Kong enacted the Misrepresentation Ordinance (MO) in 1970 and faithfully replicated the 1967 Act. Hong Kong courts have also been generous in awarding damages under the MO. Indeed as early as 1974 in *Pepsi Cola International Limited v Charles Lee*, Cons J applied the tort measure of damages to s 3(1) of MO.[41]

Here the plaintiff company took the tenancy of a house in Chung Hom Kok Road for a term of three years. On enquiry made in the course of negotiations, the agent of the defendant represented to an officer of the plaintiff company that vacant land surrounding the house was included in the tenancy.

[37] *See Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573, 591where Jacob J held that damages were still available even if the right to rescind was lost provided the claimant had a right to rescind in the past, cf *Floods of Queensferry Ltd v Shand Construction Ltd* [2000] BLR 81 and *Government of Zanzibar v British Aerospace (Lancaster House) Ltd* (2000) which say the right to damages is lost in such circumstances.

[38] *Newbigging v Adam* (1886) 32 Ch 582 and *Whittington v Seale-Hayne* (1900) 82 LT 49.

[39] [1991] 3 All ER 294.

[40] The equivalent wording in the MO is in s 3(1): "if the person making the representation would be liable to damages in respect thereof had the representation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently". *Royscott* has been tagged the "fiction of fraud" but still represents the law today in both England and Hong Kong: *see Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1996] 4 All ER 769.

[41] [1974] HKLR 13.

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The plaintiff incurred expenses in improving the surrounding land as a garden. Four months after occupation of the house, building construction commenced on the garden. The plaintiff claimed damages for misrepresentation under the MO. Misrepresentation was proven. With regard to the quantum of damages the judge said:

> "it seems clear from the language of the section itself that it (the standard by which such damages should be calculated) would be the standard otherwise adopted in actions based upon deceit, that is what the plaintiff has paid, less the value of what he has received, together with damages for any consequential loss that is not too remote."

He noted that the plaintiff had paid for a three year lease at HK$7,500 per month. The reduction in value was estimated to be HK$750 per month. He then concluded that the plaintiff had received a three year lease of something worth HK$7,500 per month for four months and only HK$6,750 for the remaining 32 months. This amounted to a loss of HK$24,000. A further loss directly consequential upon the misrepresentation was the money spent on the landscaping. This was estimated to be HK$14,000 making a total award of HK$38,000.

Mistake and Frustration

Frustration occurs when, without default of either party, a contractual obligation has become incapable of being performed because circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract: Lord Radcliffe in *Davis Contractors Ltd v Fareham UDC*.[42] The distinction between a common mistake and a situation giving rise to frustration of a contract is essentially one of timing. A common mistake is one which exists at the time of making the contract while frustration occurs after the contract has been entered into.

This distinction is well illustrated by the case of *Amalgamated Investment & Property Co Ltd v John Walker & Sons Ltd.*[43] Here the defendants sold property to the claimants for a sum well over £1 million. The property was advertised as being suitable for occupation or redevelopment and the defendants knew that the claimants wished to redevelop the property. The claimants, before contract, asked the defendants whether the property was

[42] [1956] AC 696.
[43] [1977] 1 WLR 164.

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designated as a building of special historic or architectural interest. The defendants replied that it was not but, unknown to both parties, it had been so listed on 22 August 1973. The parties signed the contract on 25 September 1973. The next day, the Secretary of State wrote to the defendants informing them that the building had been listed and that the listing would be effective the next day. The effect of the listing was to reduce the value of the property to about 12 per cent of the sale value. The claimants argued the contract should be set aside on the grounds of mistake or alternatively that the contract was frustrated by the listing of the building.

The English Court of Appeal held that the building did not become a listed one until the listing was signed by the Secretary of State on 27 September 1973. The appropriate ground was, therefore, frustration. On the facts, frustration could not be proven. The court held that the claimants knew of the risk that the building could be listed.

If a claimant can prove that the contract has been frustrated, the contract will be brought to an immediate end. The effects of frustration will then be governed by the provisions of the Law Reform (Frustrated Contracts) Act 1943 in England or by sections 16 to 18 of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23) (LARCO) in Hong Kong. These pieces of legislation enable the courts to determine the distribution of losses between the parties.[44]

Section 16(2) of LARCO provides that all sums payable under the contract prior to the frustrating event shall cease to be payable and all sums actually paid before the frustrating event shall be recoverable. There is a proviso added that enables either party to be reimbursed for expenses incurred by retaining part or whole of the sums paid to it. This retained sum cannot exceed the amount of actual expenses incurred. The court will make such an order "if it considers it just to do so having regard to all the circumstances of the case". The court can make an award in respect of expenses under section 16(2) only if there is provision for prepayment in the contract.

In addition, section 16(3) gives the court a further discretion to order the recovery of a sum from a party who has obtained a "valuable benefit", other than the payment of money to which section 16(2) applies. This sum must not exceed the value of the benefit to the party obtaining it.

Section 16(3) has proven to be controversial in relation to the interpretation of "valuable benefit". Lord Goff in *B.P. Exploration (Libya) Ltd v Hunt*

[44] For an interesting recent example of where frustration was pleaded in Hong Kong, *see Li Ching Wing v Xuan Yi Xiong* DCCJ 3832/2003. The plaintiff unsuccessfully argued that the forced vacation of his flat – which he had leased for two years – for 10 days because of the outbreak of SARS frustrated the lease. The court held that, although the outbreak may have been unforeseen, the period of interruption "was quite insignificant in terms of the overall use of the premises."

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(No 2) casts some light on the meaning of these words.[45] He held that the court must proceed in two stages: it must first identify and value the benefit obtained and then assess the just sum (not exceeding the value of the benefit) which it was proper to award. At the first stage, he held that "benefit" on the true construction of the legislation, referred not to the cost of performance incurred by the claimant but to the "end product" received by the other party. He said that the court should have regard to "the effect, in relation to the said benefit, of the circumstances giving rise to ... frustration." However, he thought that the destruction of the benefit by the frustrating event was relevant to the valuation of the benefit. This unfortunately ignores the wording of the legislation which speaks in terms of the valuable benefit being obtained *before* the time of discharge, namely, the frustrating event. This definition of valuable benefit as an "end product" would be inappropriate in, for example, a contract for the hire of a vehicle. Such a contract does not leave an "end product" in the hands of the hirer, who, nevertheless, has benefited from the use of the vehicle before the occurrence of the frustrating event.

Incidence of Mistake in Hong Kong

The rather narrow application of the doctrine of mistake at law adopted by the courts in England ever since the decision in *Bell* has generally been followed by the courts in Hong Kong. Even allowing for the expansion of the doctrine in equity following the decision in *Solle* there are relatively few cases. The defence of mistake was raised in *Jan Albert (HK) Ltd v Shu Kong Garment Factory Ltd.*[46] The mistake was as to the proper classification of garments which were to be shipped from China to Germany. At first instance Deputy Judge Cruden found that there was an operative common mistake. However, this finding was overturned by the Court of Appeal which found that the mistake did not affect the goods radically at all. The Court of Appeal also overturned a finding of the first instance court that there was frustration. The higher court did so because of the terms of the contract and the parties' knowledge or acceptance of the risk.

The impact of *Shogun Finance* and *Great Peace Shipping* on the doctrine of mistake has yet to be felt in Hong Kong as both judgments are very recent.[47] However, it is likely that the courts in Hong Kong will follow the traditional path of treating decisions of the higher courts in England with great respect.

[45] [1979] 1 WLR 783. This case went on appeal to the House of Lords but not on this point.

[46] Unrep., Civil Action No 160 of 1988 (Court of Appeal, 14 September 1989).

[47] *Shogun Finance* was cited in the Hong Kong case *Shanghai Tongji Science & Technology Industrial Co Ltd v Casil Clearing Ltd*, unrep., Final Appeal No 13 of 2003 (Civil) (Court of Final Appeal, 2 April 2004) but not in relation to mistake *per se*.

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In Hong Kong, reported cases on mistake are usually in connection with applications to rectify agreements relating to the sale and purchase of land. Such applications seek to take advantage of the long established rule of equity which gives effect to the intentions of the parties as expressed orally before entering into the written contract. The courts will rectify the written agreement to carry out the parties' intentions. Rectification will not be granted though if it has no practical purpose or if the parties had simply overlooked the matter.[48] The burden is on the party seeking rectification and the courts require convincing proof before granting such an order. The conservative attitude of the courts was shown by the Court of Appeal in *Citilite Properties Ltd v Innovative Development Company Ltd* where the court noted that it must be cautious in granting rectification.[49] This was consistent with the approach of the same court in *Cheuk Tze Kwok v Leung Yin King and Another*.[50] Here Penlington JA referred to the parol evidence rule which he described as a rule which "provides that evidence is not admissible to prove oral agreements which adds to, subtracts from or varies the terms of the written contract." He acknowledged that there are various exceptions to this rule,[51] but emphasised that these were:

> "however exceptions and there is a danger, especially in the light of the highly volatile property market of the floodgate being opened to the challenge of written contracts, as Barnett J said below, if each case is not examined with care to see if it does fit within the exception claimed."

However, a distinction needs to be made between mistakes in the recording of agreements, as in the two cases immediately above, and those made in the formation of agreements. Hong Kong cases generally fall into the former category. The courts here are, therefore, concerned mainly with the exercise of their equitable jurisdiction in deciding whether or not to grant rectification. There is a steady stream of such cases in Hong Kong and this trend seems set to continue.

With the growth in the use of the Internet and other modern means of electronic – especially visual – communication, the argument that the number of rogue cases might be on the increase, both in Hong Kong and elsewhere, appears attractive. The availability of photo identity cards should stem the

[48] *See* the examples quoted in Beale, H.G., *Chitty on Contracts* (London: Sweet & Maxwell, 27th edn, 1994), para 5–049.

[49] [1998] 4 HKC 62.

[50] [1992] HKCA 271.

[51] Such as to prove the existence of a collateral oral contract, to prove customs/trade usage, to resolve ambiguous language, to show the contract will not take effect until a future event occurs or where there is a question over the contract's validity.

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flow of such cases to a large extent. Also, the decision in *Shogun Finance* is a timely affirmation of the traditional restriction on the number of such cases. The decision of the highest court in England is not binding in Hong Kong and has yet to be followed here. The former British colony does, however, tend to follow such decisions. It can be expected, therefore, that the number of litigated cases of unilateral mistake concerning rogues will remain low in England and virtually extinct in Hong Kong.

A Need for Legislation?

As the Master of the Rolls put it in *Great Peace Shipping*, the examples set by enacting legislation in the area of frustration – and one can add the area of misrepresentation as well – make it logical for the legislature in England to grasp the nettle and bring mistake into line with misrepresentation and frustration. The author suggests that the same logic applies to Hong Kong. The wording of section 16(2) of LARCO can be used as a starting point and adapted to cover cases of operative mistake where the contract has made provision for a prepayment. The wording of this subsection gives the court a wide discretion which would enable it to take into account differing circumstances which may not be easily anticipated.[52] Less clear is whether or not there should also be a provision for a "valuable benefit". As noted above, the wording of section 16(3) of LARCO has caused problems. If a similar provision for "valuable benefit" is to be enacted for mistake then the lessons learned from the operation of the legislation on frustration in this area should be taken on board to avoid these problems.

This is a chance for Hong Kong to show that it is no longer tied to the skirts of its erstwhile colonial master by enacting legislation which brings the law of mistake into line with that of misrepresentation and frustration and more accurately reflects the real business situation before the English parliament so acts.[53]

Conclusion

The expanded role given by both the courts and legislation to misrepresentation – and to a lesser extent frustration – and the restriction of the application

[52] "If it considers it just to do so having regard to all the circumstances of the case".

[53] Hong Kong usually follows any changes in legislation in England dealing with contractual issues. A current example is the appointment of a subcommittee by the Law Reform Commission in Dec 2002 to examine the doctrine of privity of contract. This is in the wake of the enactment in England of the Contracts (Rights of Third Parties) Act 1999.

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of the doctrine of mistake in cases such as *Shogun Finance* and *Great Peace Shipping* raises the question whether or not there is a meaningful role left to be played by the doctrine of mistake. The correct conclusion appears to be that while misrepresentation can provide a very satisfactory and arguably more flexible alternative to the doctrine of mistake, there are still a number of cases, albeit small in number, where mistake provides the only possible remedy. Therefore, there is still a meaningful, if not irreplaceable, role left to be played by the doctrine of mistake.

The doctrine may have been rationalised by the courts in *Shogun Finance* and *Great Peace Shipping* but there is no evidence that the doctrine may be about to become extinct. There are situations such as *Bell* itself where a misrepresentation was not present and so the only cause of action available was one in mistake. Although the plaintiff in *Bell* did not succeed in establishing an operative mistake, two of the judges in the House of Lords did think there was.[54] The comments of the Law Lords in *Shogun Finance* about the increased likelihood of face-to-face situations coming with advances in modern technology – such as videophones – indicate that the doctrine of mistake may well assume greater importance and force lawyers to go back to a consideration of basic contract law such as is happening in the area of offer and acceptance, with the advent of the Internet and the much greater ease at making contracts online which throws up more opportunities for fraudsters to operate.

However, while the incidence of rogue cases may be on the increase, the comments of the court in *Shogun Finance* seem to have made it virtually impossible to succeed in cases of unilateral mistake in face-to-face situations. The criminal law in relation to fraud is moving to meet the challenges posed by the potential explosion in the number of fraud cases brought on by advances in information technology. The best piece of advice for a victim of a rogue case would seem to be to rely on the police to catch the rogue and use the criminal law to obtain compensation.

The doctrine of mistake may well have a significant role to play in the areas of common and mutual mistake but there remains the unsatisfactory situation with regard to the apportionment of losses when an operative mistake is established. It is time to enact legislation such as has been done for misrepresentation and frustration, so that the continued operation of the doctrine of mistake can provide equitable solutions in a practical business environment and justify its continued use in contract law.

[54] Lord Warrington and Lord Hailsham.

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